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No. 430

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

UNITED STATES OF AMERICA
Petitioner,

vs.

OGILVIE HARDWARE COMPANY, INC.
Respondent

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

H. C. WALKER, JR.,
ELIAS GOLDSTEIN,
Attorneys for Respondent.

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SYLLABUS

1. By the 1942 amendment to Section 26 (c) of the 1936 Revenue Act, Congress placed on the same footing with regard to liability for surtax on undistributed profits deficit corporations which were forbidden by a state law from declaring dividends and those which were prohibited from so doing by a written contract antedating May 1, 1936.

2. A stock dividend lawfully declared prior to May 1, 1936 in the regular course of business and without intention to avoid or reduce income tax liability converts surplus assets into capital which is no longer available for distribution to stockholders.

3. Where such addition to capital occurred prior to May 1, 1936, it became a part of the capital of the corporation for all purposes; and except in those instances where Congress has specifically otherwise directed, it will be considered a part of the corporate capital in relation to income and other Federal taxes.

4. Under Louisiana law a deficit corporation such as respondent was at the close of its fiscal years ending May 31, 1937 and May 31, 1938 is strictly prohibited from declaring a dividend.

5. Under the practice and rules of this Court, a case involving merely the construction of a provision of the Federal Revenue laws which Congress has long ago repealed is not of sufficient importance to justify a review by this Court of the decision of a Circuit Court of Appeals interpreting such provision.

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MAY IT PLEASE THE COURT:

We can add nothing to the clear statements of the facts which will be found in both the opinion of the Court of Appeals (R. 35) and the petition for certiorari (pp. 2 to 4, incl.). We therefore pass at once to the legal issues.

We respectfully submit that certiorari should be denied here because

(a) The decision and opinion of the Court of Appeals are completely right;

(b) The question presented is one of liability for an undistributed profits tax under a section of the Federal tax laws which Congress has repealed and which is, therefore, not of sufficient importance to require interpretation by this Court;

(c) There is no conflict of decision among the three courts of appeals which have heretofore passed upon the matter when the decisions are considered in the light of what the court of appeals found to be the facts in each case.

We pause for an instant to supplement the statement of the question presented (Petition, p. 2) by adding this: The stock dividend was declared for an honest business purpose many years before Congress penalized nondistribution by corporations of current earnings.

We first discuss the "Reasons for Granting the Writ" as set forth in the petition.

We respectfully differ with the distinguished counsel for Petitioner in regard to the conflict between the decision in this case and that of the Eighth Circuit Court of Appeals in *Century Electric Company v. Commissioner, 144 Fed. (2d) 983.* We take the facts in the Century case as they are stated in the opinion of the Court of Appeals: for it was on the basis of those facts that the case was decided; and since we are interested

in the Century Electric Company case only from the standpoint of what it decided as a matter of law, the accuracy of its findings of fact is of no moment here. In order for there to be a conflict between the decision in the Century Electric Company case and the decisions in this case and in the case of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, there must be such a similarity of facts as found by the Courts of Appeals as would preclude a valid distinction between what was held to be the law in the three cases.

With the utmost deference for the opposing view, we submit that the vital distinction between the facts in this case and the facts as stated by the Court of Appeals for the Eighth Circuit in the Century Electric Company case was correctly pointed out by the Court of Appeals for the Sixth Circuit in the *Byron Sash & Door Company* case, supra.

> "According to the statute, the credit is allowed to a 'corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year.' What appears to us to have been a misconception on the part of the Collector is emphasized by a reference to the principal case on which the Government relies, Century Electric Co. v. Commissioner, 144 Fed. (2d) 983. (C.C.A.8) (44-2USTC §9463). There the corporation had large accumulated earnings and profits at the close of the taxable years 1935 and 1936, respectively. There was no claim that it had any deficit in earnings and profits for these years. In the year 1936, and again in 1937, it distributed non-taxable stock dividends. Before the Tax Court, as well as before the Circuit Court of Appeals, the corporation contended that by reason of the distribution of such stock dividends, it had become a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, within the meaning of Section 26 (c) (3) of the Revenue Act of 1936, as amended by the Revenue Act of 1942, Section 501

(a) (2), 26 U.S.C.A. Int. Rev. Acts; and that it was entitled to the credit of that section because it was prohibited from paying dividends by state law. The Court denied the credit on the ground that the non-taxable dividends distributed in 1936 and 1937, did not result in such a reduction in the earnings and profits for those years respectively, as to bring the company within the provisions of the statute as a deficit corporation. In other words, the Court held that where a corporation had a surplus, a deficit within the meaning of the statute under which a credit is allowed could not be effected by the distribution of a non-taxable stock dividend. In the Century Electric case, there was, therefore, no deficit but rather a surplus as of the close of each of the two taxable years preceding the distribution of the dividends, and accordingly no credit was allowed by the provisions of the statute. See also the report of the same case, Century Electric Co. v. Commissioner, in 3 T.C. 297 (CCH Dec. 13, 744). The obvious difference between the Century case and the one before us is that in the former, the claimed deficit was effected by the distribution of the stock dividends, while in the instant case it was effected by the preceding seven years of operating losses."

The difference between the facts in the *Century Electric Company* case and the facts in the instant case is sought to be minimized in the petition here (p. 7); but that it does exist exactly as stated by the Sixth Circuit decision in the *Byron Sash & Door Company* case appears when the opinion in the *Century Electric Company* case is read; for this is what the Circuit Court said were the facts upon which its decision was made:

"It appears that the taxpayer was at no time insolvent and its books showed large accumulated earnings and profits at the close of the taxable years 1935 and 1936, respectively, but instead of distributing the earnings and profits to its stockholders it had distributed non-taxable stock dividends,

common stock for common stock. It contended before the Tax Court, and contends here, that by reason of such stock dividends (and certain other claimed adjustments of its balance sheets) it had become a deficit corporation ('a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year') within the meaning of Section 26(c) (3), and that it was entitled to the credit of that section because it was prohibited from paying dividends by the law of Missouri where it is domiciled. The Tax Court held, in accord with Treasury Regulation 94, Rev. Acts 1936, 1942, Art. 26-2 (as amended by T. D. 5263, 1943 Cum. Bull. 1003, 1005, 1006 (d), that the non-taxable stock dividends distributed by the taxpayer did not serve to reduce the earnings and profits of the taxpayer, and that it had not become a deficit corporation within the meaning of the Act."

(*144 Fed. (2d) 983.*)

Expressions will be found in the *Century Electric Company* decision which are inconsistent with what the Court of Appeals for the Fifth Circuit said in its opinion here; but it is a familiar rule of law that what is said in an opinion is to be taken in connection with and as applied to the facts in that particular case and is not to be construed as stating a general rule applicable to different situations and different facts.

The second reason given for filing of the petition to review the construction by the court below of an unambiguous section of a tax law which has been repealed by Congress is that the court below held the law as passed by Congress to be of greater force than the Treasury Regulation interpreting it and also held that since the wording of the law is sufficiently plain to convey to the ordinary mind the sense of the words used, thus requiring no extrinsic aids to construction, it is not necessary to resort to a report of the Senate Committee on Finance for further light upon the meaning of the statute.

What the Court of Appeals held was what this Court under similar circumstances has repeatedly said. In *Lake County v. Rollins, 130 U. S. 662, 32 L. Ed. 1060,* this Court broadly laid down the general rule of construction of statutes and constitutions.

"We are unable to adopt the constructive interpolations ingeniously offered by counsel for defenddant in error. Why not assume that the framers of the Constitution and the people who voted it into existance, meant exactly what it says? At the first glance, its reading produces no impression of doubt as to the meaning. It seems all sufficiently plain; and in such case there is a well settled rule which we must observe. The object of construction, applied to a Constitution, is to give effect to the intent of its framers, and of the people in adopting it. This intent is to be found in the instrument itself; and when the text of a constitutional provision is not ambiguous the courts, in giving construction thereto, are not at liberty to search for its meaning beyond the instrument.

"To get at the thought or meaning expressed in a statute, a contract or a Constitution, the first resort in all cases, is to the natural signification of the words, in the order of grammatical arrangement in which the framers of the instrument have placed them. If the words convey a definite meaning, which involves no absurdity nor any contradiction of other parts of the instrument, then that meaning, apparent on the face of the instrument, must be accepted, and neither the courts nor the Legislature have the right to add to it or take from it. Newell v. People, 7 N. Y. 97; Hills v. Chicago, 60 Ill. 86; Denn v. Reid, 35 U. S. 10 Pet. 524 (9:519): Leonard v. Wiseman, 31 Md. 204; People v. Potter, 47 N. Y. 375; Cooley, Const. Lim. p. 57; Story, Const. § 400; Beardstown v. Virginia, 76 Ill. 34. So, also, where a law is expressed in plain and unambiguous terms whether those terms are general or limited,

the Legislature should be intended to mean what they have plainly expressed, and consequently no room is left for construction. United States v. Fisher, 6 U. S. 2 Cranch, 358, 399 (2:304,317); Doggett v. Florida R. Co. 99 U. S. 72 (25:301)."

(*32 L. Ed. 1063.*)

See also,
Caminetti v. United States,
242 U. S. 470, 61 L. Ed. 442.

The decision of this Court in *Bate Refrigerating Company v. Sulzberger, 157 U. S. 1, 39 L. Ed. 601,* is directly in point here.

" 'Where the language of the Act is explicit,' this court has said, 'there is great danger in departing from the words used, to give an effect to the law which may be supposed to have been designed by the legislature . . . It is not for the court to say, where the language of the statute is clear, that it shall be so construed as to embrace cases, because no good reason can be assigned why they were excluded from its provisions.' Denn v. Reid, 35 U. S. 10 Pet. 524, 527.

* * * *

"We cannot accept as controlling, much less conclusive, the opinion of the House Committee on the Revision of the Laws of the United States, as reported by Mr. Jenckes, that the bill it reported embodied only the existing law. Nor can we assume that the House of Representatives, much less the Senate, based their action upon the opinion of individual members of the House as to the scope and legal effect of the report of the revisers. Comparing the bill reported by the revisers and the bill reported by the House Committee on Patents, with the Act as it passed, we find it impossible to sustain the view taken by the plaintiff."

(*39 L. Ed. 611, 613.*)

The same argument that is advanced by the Petitioner here was rejected by this Court in *Pennsylvania Railroad Co. v. International Coal Mining Company, 230 U. S. 184, 57 L. Ed. 1446.*

> "But while they may be looked at to explain doubtful expressions, not even formal reports—much less the language of a member of a committee—can be resorted to for the purpose of construing a statute contrary to its plain terms, or to make identical that which is radically different."
>
> *(57 L. Ed. 1452.)*

To the same effect, see

Standard Fashion Company v. Magrane-Houston Company, 258 U. S. 346, 66 L. Ed. 653.

> "Much is said in the briefs concerning the reports of committees concerned with the enactment of this legislation, but the words of the act are plain, and their meaning is apparent without the necessity of resorting to the extraneous statements and often unsatisfactory aid of such reports. See Railroad Commission v. Chicago, B. & Q. R. Co., decided February 27, 1922, 257 U. S. 563, ante, 371, 42 Sup. Ct. Rep. 232, and previous decisions of this court therein cited."
>
> *(66 L. Ed. 657.)*

We have seen no better statement on the point than was made by the Court of Appeals in this case *(R 37)*:

> "That divergent meanings be given the same words in the beginning and end of the same clause is said to be required because the Committee which recommended the amendment to the Senate, after stating the object of the amendment as we have just stated it, illustrated its operation by two examples, in the latter of which it was indicated that when 'the deficit on the corporation's books was by reason

of a prior capitalization of surplus in the course of a non-taxable reorganization the deficit, so far as thus caused, would not be recognized though it might be by the State law. This example was copied into the Regulations also. It actually speaks only of reorganizations and not of stock dividends. We do not think the example is any part of the unambiguous Act of Congress. It is merely the opinion of the writer of the report on how the legislation would work out in the case of a non-taxable reorganization. The Constitution, Article 1, Section 7, states how the laws of the United States are made: by written Bill, passed by the House and Senate separately, transmitted to the President and approved by him, or passed over his veto. The provision is express that thus the same (the Bill) shall be a Law.' The report of a Committee of the Senate is not voted on—perhaps not read by—the members even of the Senate; but the words of the Bill are. The Bill is transmitted to the House, and it—not the Committee's report— is passed there. The Bill is then sent to the President for his approval. He does not approve a Committee report, if by any chance he should see it. He approves the words of the Bill and it becomes the law. Under the statutes on the subject the Bill as soon as passed by either House is printed and becomes the authentic Bill: 1 U. S. C. A. § 26. On final passage and printing, 44 U. S. C. A. § 196, the printed Acts are evidence of the laws passed; 1 U. S. C. A. § 30. The words of the Act are the law. Only when the words of the law are difficult of understanding can what happened in passing it be resorted to for aid. Its clear meaning cannot be so altered. Nor can anything be thus added to it. Nor can putting an example into the Regulation add to or change the law as passed."

"So recourse is had to Section 115 (h) of the Revenue Act of 1936, in substance stating that a distribution by or on behalf of a corporation shall not

be considered a distribution of earnings and profits of the corporation if no gain to such distributee was recognized by law or if the distribution was not subject to tax because it did not constitute income to him within the meaning of the Sixteenth Amendment. This Section has reference not to the taxes or credits of the corporation, but only to the taxation of the shareholder, as a reading of the whole Section will show. Subsection (h) means that when the shareholder gets something in the way of a dividend which is not presently taxable, it will be held taxable as a dividend when the impediment is removed, or the value which he has received is finally realized. Thus in Eisner vs. McComber, 252 U. S. 189, a stock dividend, which is a capitalization of earnings and profits of the corporation, was held not presently taxable to the shareholder because he had not realized any gain; but when on the liquidation of the corporation, or by sale of his stock he does realize the gain, it is all then taxable to him as gain. We do not think this provision has any bearing on the 1942 amendment under discussion, which relates to the taxation of the corporation itself for not distributing its current income."

(*R. 37, 38.*)

While we can see the importance in the case of a complicated and ambiguous statute of an examination of the legislative records behind the passage of the act, we submit that the Courts of Appeals correctly held that there was neither occasion nor excuse for resort to such extrinsic evidence when the language of the statute itself (the words being given their ordinary meaning) clearly indicates what Congress intended and what the President, whose approval was an essential part of the enactment of the statute into binding law, assented to. There is no implicit difference between the rules of construction of contracts between individuals and those properly applicable to the construction of a law. In either case the authority charged with the duty of con-

struing the contract or the law, as the case may be, looks first to the ordinary meaning of the language used. If that meaning is plain, the construer is required to go no further; but if the expressions used are ambiguous, then and then only is an inquiry justified into the background of the contract or the law and the surroundings in which it was confected or adopted.

We respectfully submit that when Congress passes a law and the President approves that law so that it becomes binding within constitutional limits upon the United States and upon all persons, and when the terms of that law are sufficiently explicit for its meaning to be understood by a competent court, Congress is conclusively presumed to have intended to enact the law in the words in which it is expressed and the President who approved the law is conclusively presumed to have approved it as written and the courts of the country and the Bar as a whole and the man in the street to whom the law applies are entitled to rely upon the plain and ordinary meaning of the words in which the act is couched and should not be obliged to test that meaning by what was said about the law before it was passed either in the Senate or in the House or in a committee report or in any other place.

We have here a law which is sufficiently plain for anyone to read and understand; and we submit that the law should be applied as it is written without regard to the interpretations of the law by a member of Congress, a Congressional Committee, a cabinet officer, a Treasury official, the Attorney General, or anyone else.

The third reason given for asking this Court to disturb the proper application of a repealed statute to a case arising prior to the repeal is that,

> "The question presented is nevertheless very much alive in cases pending in the District Courts within the Third, Fifth, Sixth, Seventh and Tenth Circuits, involving substantial amounts of revenue. It is in the interest of consistent administration of

the tax laws that the issue be authoritatively set at rest by this Court."

It seems almost incredible that an appeal should be made for consideration of this case by the Supreme Court of the United States on such a ground. Almost implicit in the language used is the assumption that this Court has become little more than a part of the administrative section of the Treasury Department. There is no evidence in this record to show that other cases involving the same question are pending in district courts; it appears to us in general to violate the proper conception of judicial process to seek a decision of a matter by this Court not on the basis of the record in the case but on the strength of statements made by counsel as to facts outside the record. Assuming the verity of these facts and assuming that "substantial" amounts of revenue are involved, what has that to do with the granting of a writ of certiorari by this Court? And what is meant by "substantial" amounts of revenue?

We assume that the Petitioner has stated its case as strongly as possible and that there is a case pending in the Third Circuit and one in the Fifth Circuit, one in the Sixth Circuit, one in the Seventh and one in the Tenth Circuit involving this same question. Let us suppose that they are all decided in a way that this Court would not decide them. We still say that because of the repeal of the statute and because no matter what is the decision of this Court, it will guide no one in respect to future tax liability, attempted resort to the supervisory power of this Court in a case like this is an imposition on the time of the Court and a waste of that time; it implies a lack of respect for the dignity of the Court and for the importance of its functions and powers.

On the merits of the case it is difficult to improve upon the opinion of the Court of Appeals; but we supplement it by these observations:

In amending paragraph 3 of Section 26 (c) of the Revenue Act of 1936 so as to afford relief to corporations situated similarly to the respondent here, Congress in 1942 enacted and the President approved a provision retroactively relieving certain deficit corporations from the penalties of the 1936 statute; and these are the words of the statute itself:

> "(3) Deficit corporations. In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

It will be noted that the amendment to the statute uses the expression "deficit in accumulated earnings and profits" twice. We think there can be no reasonable ground for denying that the second use of the expression refers to a deficit in accumulated earnings and profits as determined by the law of the state: for the existence of a deficit in itself does not authorize the exemption—there must be both the deficit and a provision of a law or an order of a public regulatory body prohibiting payment of dividends while such deficit exists. It is manifest that Congress was referring here to a provision of state law and it is equally manifest that it was referring to a deficit in accumulated earnings and profits as defined by that state law to constitute a bar to the payment of dividends.

It was stipulated (*R. 15*) that the taxpayer's books on May 31, 1936 disclosed a deficit of $74,875.10 and on May 31, 1937 a deficit of $71,347.18. The Louisiana statute (Act No. 250 of 1928) which is reproduced on pages 13 and 14 of the petition for certiorari in unmistakable terms prohibits payment of dividends by any corporation where the effect of such payment would be the diminution of the capital; and certainly a

corporation which has a large deficit instead of a surplus at the end of its fiscal year cannot pay a dividend except out of what is left of its capital.

The Petitioner attempts to avoid this conclusion by separating the capital of the Respondent into two parts, one being that which was originally subscribed and the other being the addition to the capital as a result of the stock dividend declared in 1924. As to the latter, the Petitioner assigns to it an amorphous character as both capital and surplus and contends that although for other purposes it was merged into and became a part of the new capital of the corporation, for the purpose of the question involved here it remained a part of the surplus. Petitioner argues accordingly that treating the half of the capital which was added in 1924 not as capital but as surplus has the effect of transforming the Respondent from a corporation with a deficit to a corporation with a surplus and thus deprives it of the protection which Congress in the 1924 Revenue Act extended to corporations prohibited by state law from declaring dividends.

The argument thus made it not consonant with universally accepted principles of the law of corporations. In *Fletcher Cyc. Corp., Perm. Ed., Vol. II, Title "Stock and Stockholders", Chap. 5362,* the general rule is thus succinctly stated:

"A stock dividend converts surplus assets into capital."

Among the authorities cited to support the text are,

Equitable Trust Company v. Prentice,
250 N. Y. 1, 164 N. E. 723;

Harding v. Staples,
111 Ken. 325, 149 Atl. 846;

Green v. Bissell,
79 Conn. 547, 65 Atl. 1056; 8 L. R. A. (NS) 1011;
118 Am. St. Rep. 156; 9 Ann. Cas. 287;

Bryan v. Aikin,
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In re Joy's Estate,
247 Mich. 418, 225 N. W. 878;

Lamb v. Lehmann,
110 Ohio St. 59, 143 N. E. 276;

In re Estate of Heaton,
89 Vt. 550, 96 Atl. 21;
L. R. A. 1916A 201;

to which list we add,

Eisner v. Macomber,
252 U. S. 189, 64 L. Ed. 521;

Commissioner v. Cordingley,
78 Fed. (2d) 118 (1st Cir.);

Patty v. Helvering,
98 Fed. (2d) 717 (2nd Cir.);

Commissioner v. Champion,
78 Fed. (2d) 513 (6th Cir.);

Commissioner v. Quackenbos,
78 Fed. (2d) 156 (2nd Cir.);

Commissioner v. Ahlborn, et al.,
77 Fed. (2d) 700 (3rd Cir.).

In *Green v. Bissell*, supra, the Supreme Court of Connecticut held that,

> "The declaration of a stock dividend involves the creation and issue of new shares of stock. The basis of the issue, in so far as payment into the corporation is required of the recipient, is surplus assets which thus become converted into strict capital with all which that implies.";

and in *Lamb v. Lehman*, supra, the Supreme Court of Ohio said,

> "A declaration of a so-called stock dividend has no other effect, so far as the corporation itself is

concerned, than to carry the position of the surplus covered by such stock dividend into the permanent capital account, thereby placing it beyond the power of the Board of Directors to withdraw it from corporate use and distribute to stockholders.";

and in *In re Estate of Heaton*, supra, the Supreme Court of Vermont declared that,

"Such dividend operates to transfer distributable assets to the individual ownership of the stockholders, thus changing accumulated surplus into permanent capital, and thereby creating an additional liability of the corporation."

In *Eisner v. Macomber*, supra, this Court pointed out that,

"A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. *Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.*"
(*Emphasis ours.*)

In the application for certiorari it appears to be assumed that there is a so-called "Federal rule" which is different from the jurisprudence of the state courts over the country; but no such "Federal rule" is found in the decisions of the Federal courts and there is nothing in the Federal law itself nor the jurisprudence interpreting that law which differentiates the meaning of the term "deficit in accumulated earnings and profits" from the meaning generally and consistently given to such term by both state and Federal courts in a long series of decisions extending over a period of many years.

In *Commissioner v. Cordingley, 78 Fed. (2d) 118,* the Court of Appeals for the First Circuit said:

> "We think there was a consistent legislative purpose in the statutes beginning with the act of 1921 and extending into the act of 1928, viz., that corporations should be permitted to capitalize earnings by stock dividends issued for legitimate purposes, that stock so issued should stand on the same footing as other stock, and that the owner of it should be taxed on the profit or loss when it was converted into money. As has been said, this view has been long accepted by the Board of Tax Appeals and by various courts of appeal before which the question has come.";

and in *Commissioner v. Quackenbos, 78 Fed. (2d) 156,* the Court of Appeals for the Second Circuit slightly elaborated on this view, which met with its approval.

> "We can see no difference between capitalizing surplus earnings and investing them in plant or in using them, when so capitalized, as working capital that is advantageous for the conduct of the business. Here the earnings were not temporarily impounded, but subjected to the risk of the business of the Woonsocket Worsted Mills for eight years. The language of subsection (g) making the test whether the redemption and distribution are 'essentially equivalent to * * * a taxable dividend' depend on the 'time' and 'manner' of redemption clearly shows that not every redemption of stock and distribution of capitalized earnings which have accrued since Feb. 28, 1913 is 'essential equivalent to * * * a taxable dividend'. A long series of decisions of the Board of Tax Appeals has made the test of whether a distribution is 'essentially equivalent to * * * a taxable dividend' turn on whether the capitalization was for an honest business purpose and that again to depend on the particular facts of each case."

The overwhelming weight of authority is to the effect that when the Respondent transferred $100,000

from its surplus to its capital account in 1924 by declaring a stock dividend, its capital thereafter was $200,000 whereas it had been $100,000; and this $200,000 was its capital for all purposes—not merely for some. This stock dividend was declared by the Respondent many years before Congress levied a tax upon undistributed profits. It was a corporate act done in good faith for a strictly business purposes and had no relation to the avoidance or reduction of Federal income taxes. There is, it seems to us, no logical basis for the attempted distinction between the capital originally subscribed and the addition made to it in 1924.

This was the conclusion of the United States Circuit Court of Appeals for the Sixth Circuit in the case of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, in which the court after stating facts closely analogous to those in the present case, said:

> "The Commissioner's contention is based upon the ground that the taxpayer's deficit was the result of the $130,000 non-taxable stock dividend declared in 1929. It is argued that, since non-taxable stock dividends do not affect or diminish earnings and profits, they, therefore, cannot cause a deficit, and there was in this case, therefore, no deficit in the taxpayer's accumulated earnings or profits."

The court then refers to the argument of the Commissioner that because Section 115 (h) of the Internal Revenue Code provides that such a stock dividend shall not be considered a distribution of earnings or profits of the corporation, it cannot cause a deficit in earnings and profits and that,

> "Because the foregoing section provides that a stock dividend, like that in this case, shall not be considered a distribution of earnings or profits, it is urged that such a dividend cannot cause a deficit in earnings and profits, and that, consequently, a corporation whose deficit on its books results from

a distribution of tax-free stock dividends may not, within the meaning of the statute, have the benefit of the credit granted by Section 501 of the Revenue Act of 1942."

Then the court pointed out what the Commissioner had overlooked; and what it said is just as applicable to this case as to the case before it.

"Appellee does not claim that the distribution of the stock dividends was a distribution of the company's earnings and profits. On the contrary, it is maintained that there never was any such distribution, but rather that the earnings and profits were capitalized by the act of the corporation in transferring them to its capital account and were no longer available for distribution to stockholders. It is submitted by appellee that by the action of the corporation, the earnings and profits became, as of the time of the declaration of the dividend, merged and coalesced with the capital, and became subject to all the limitations imposed by law upon corporate capital.

"Section 115 (h) deals with the taxable status of the stockholder who receives stock dividends, rather than with the liability of the corporation for tax, and to use this provision of the statute in order to ignore the deficit in the case before us, and to deny credit on undistributed profits surtax to this corporation, seems untenable."

In the petition for certiorari reference is made to the decision of this Court in *Commissioner v. Estate of Bedford 325 U. S. 283, 89 L. Ed. 1611*, as presenting a situation similar to the one before the Court here. It does not seem to us that the similarity exists. On the contrary, the facts in the two cases are so different that the opinion of this Court in the Bedford case appears to us to be irrelevant here. In the cited case the taxpayer was a holder of shares of Abercrombie & Fitch Company, which was reorganized, the reorganization resulting in a distribution of both stock and cash.

"The sole issue is whether the tax, $45,240, is taxable as a dividend or merely as a capital gain to the extent of 40%."

There was no question in the Bedford case of any tax on undistributed profits or relief from such tax, and *it was conceded that although a book deficit in the surplus account had been created by earlier stock dividends, earnings and profits exceeding the distributed cash had been earned at the time of the recapitalization.*

"That cash therefor came out of earnings and profits and such a distribution would normally be considered a taxable dividend, see § 115 par. (a), 26 USCA § 115(a), 6 FCA, Title 26, § 115(a)."

All that the court held in the Bedford case was that cash distributed by a corporation to its shareholders is a taxable dividend if the cash came out of the earnings of the corporation since February 28, 1913; and having found in the Bedford case that the cash received by the taxpayer was a dividend, it held the taxpayer liable for income tax thereon.

What this holding has to do with the decision of the case at bar we cannot see. There is no question here of the impact of the income tax laws or any provisions thereof upon a shareholder, and there is no question of the payment of dividends. It is useless to attempt to draw from a decision construing one provision of the Federal income tax laws a conclusion as to liability under another and separate provision. In matters of taxation—and particularly income taxation—it is the statute and not reason and logic and equity which determines liability. Every income tax statute so far passed abounds in inequities, inconsistencies and inequalities. It is the language which Congress uses and which the President approves in enacting a particular provision of the revenue laws that determines liability under that provision; so that a case which deals only with the liability of a stockholder for the receipt of cash cannot reasonably be said to be authority

for the construction one way or the other of another part of the income tax laws which deal with the imposition of a surtax or undistributed profits of a corporation. When it is attempted to draw such inferences, they are usually incorrect and misleading.

It is respectfully submitted that the facts in this particular case bring the Respondent directly within the class of corporations which Congress by the 1942 amendment to the 1936 Revenue Act attempted to relieve from the surtax on undistributed profits—an attempt which is bound to prove successful unless the words of the statute are twisted into something other than their normal meaning.

It follows that the opinion and judgment of the Court of Appeals which affirmed the judgment of the district court in favor of Respondent are correct and that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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